COMMUNICATION

SHOULD PUBLIC FRANCHISES BE TREATED AS CORPORATE PROPERTY?

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Though widely accepted, the familiar theory that a public franchise granted to a corporation has the character of private property is open to serious objections. Franchises are taxed as private property where public service corporations are subjected to state control of even the simplest form. At the same time, the revenue which is thus secured, being offset by certain corporate burdens thrown upon the public, is less advantageous than might at first sight appear.

A special franchise is of its nature a grant of a public right to a private individual or corporation. Commonly it is a right to the use of streets, highways, and public places for the purposes of lighting, transportation, water supply, and other public utilities. It usually happens that the right granted is practically, if not theoretically, exclusive—that is, the corporation to which it is given will not be disturbed in the exercise of the privilege by a competitor. A special franchise is thus to a certain extent a license to engage in some form of monopoly, and it commonly implies an unusually favorable opportunity for commercial gain. The value of this commercial privilege may be readily expressed in figures, by a computation showing the amount of capital which would be necessary in ordinary safe investments to produce the same income. Of course it is only proper that if such a right is to be conferred upon any private corporation the public should be liberally compensated therefor, by taxation or otherwise.

It is easily to be perceived, however, that the commercial value of the franchise is derived mainly from the principle of monopoly, for without monopoly the mere exercise of the privilege to use the streets for a definite purpose would be subject to the risks and uncertainties of ordinary competitive trade, and those engaged in it would in many cases derive no profit from the franchise at all, over and above the profit on the money actually invested. The award of franchises under a competitive policy is, of course, open to grave objections. It is here referred to merely for an illustration. Let us suppose, for example, that a city were to bestow the right to use its streets upon a number of street railway companies operating in close competition within a restricted territory. It is easy to see that if by careful management each of these companies was able to pay fair dividends on the capital actually invested in tangible property, it would be doing exceedingly well. There could be scarcely any opportunity, under close competition, for any profits in excess of a reasonable return on the actual investment. The franchises granted these companies, therefore, assuming that the city

has not made them pay for them, represent no commercial privilege which has a money value; they are public rights pure and simple, juridical rather than economic in their character, and though they have been assigned to private parties they still retain more of the nature of public privilege than of private property. The commercial value cannot come in until the granting of franchises is attended with concession of special opportunities for gain. The grant of a right of monopoly has a pecuniary value which is by no means commensurate with the value of the intangible public right. The latter, in fact, is immeasurable as regards value, and is in itself devoid of a commercial aspect.

It is not solely from the monopoly, however, that the money value of a public franchise is derived. A franchise is very often a permit to practice legalized forms of extortion from the public. Among gas and street railway companies, dividends of seven and eight per cent are the usual thing, and some pay even more on their capital stock. Numerous forms of stock-watering are devised to swell the profits of the corporation at the expense of the public. Not only are earning capacity and surplus capitalized, but stock is issued for debts improperly contracted, for accumulated and sometimes superannuated property which is of no use for the public service in question, and for duplications of plant which the corporation formed by consolidation proposes to continue rather than eliminate. Not only is the capital stock swollen to needlessly large proportions, imposing a serious burden of exorbitant dividends upon the public, but improvements which might bring about an improvement of service or a reduction of prices are neglected. Public opinion meekly tolerates all this, and even in conservative Massachusetts, where the checks on stock-watering are stronger than in any other state, a corporation like the Boston Consolidated Gas Company was permitted to capitalize a debt of $6,000,000 without being called upon to show for what purposes this indebtedness was contracted. The prevalent attitude both of the public and of legislatures regards public service corporations not as companies organized for the express purpose of financing and carrying along public utilities on such terms as the state may direct, but as ordinary commercial enterprises enjoying the right to wrest all the profit the law will allow from their customers. The usual view, in fact, is that public service corporations are privileged, like all commercial enterprises, to employ distinctly mercenary methods and seek to secure large profits, rather than that they are safeguarded investments under the tutelage of the state from which predatory methods should be rigidly excluded by statute. In accordance with the prevailing view, the license to engage in a spoliation of the public must of necessity possess great commercial value. The misconception which disregards the nature of a public right, treats it as a business asset, and exploits it to the injury of the public, is thus another cause which co-operates with the concession of monopoly to give to public franchises an enormous money value.

If this way of treating a franchise as a business asset did not result in extortion it would be a very different matter. As a matter of fact, however, the practical results are pernicious. The corporation which regards its fran-

chise as an asset will, of course, seek to derive advantages from it, and such advantages are close at hand and may readily be turned to account. Unless rendered impossible by state regulation, the most natural step is the capitalization of the franchise, which fastens a heavy burden upon the public. As a franchise has scarcely any fixed commercial value independent of the astuteness of the corporation, the valuation determined for the franchise can hardly fail to be excessive. But if statutory restriction renders the capitalization of the franchise impossible, the corporation will still endeavor to obtain the benefits attending its permit to engage in commercial exploitation, and will have recourse to the many other possible methods of stock-watering which present themselves as possible alternatives to franchise capitalization. Of course if the public treats the franchise as a bonanza the corporations will.

The cases in which a city exacts compensation for the franchise, in the form of a sale or lease on good terms, may seem to contradict the foregoing argument. For if the city exacts a price fully covering the value of the concession, one might suppose that the result would be the same as if there had been no concession. But the objection to such cases is that the corporation will naturally seek to obtain profits far in excess of the amount to be paid the city for the franchise. If the transaction is a sale, a large amount of stock will be issued, and by a swollen capitalization the chance for concealed profits becomes highly advantageous to the purchasing company. Or if the franchise is disposed of on a lease, the corporation will find a way to pay the lease and at the same time convert it into a source of profit. It is not to be expected that corporations will treat franchises for which they are compelled to pay large sums as anything else than property subject to the ordinary laws of traffic and as the source of increased income. The lack of enforced publicity in the accounts of the public service corporations, which is a serious want, is especially favorable to the practice of methods which compel the public to pay more, in the prices of utilities, than the corporation pays the city for the franchise.

So generally is the practice of the alienation of public rights for purposes of private gain tolerated, that it is difficult, perhaps, for the reader to see just what its abandonment would entail. The reform, however, is simple enough in principle. Treat a franchise as a grant of a public right as before, but a grant which does not destroy the character of the public right by transmuting it into a commercial concession. Give it to the public service corporation, without exacting compensation in return, and do not permit it to be capitalized. Treat the franchise thus disposed of, not as an absolute monopoly which the constitutional safeguards against impairment of contract compels the state to protect, but as a monopoly continuing only during good behavior, terminable at will for good cause. Above all, by state regulation of capitalization and enforced publicity of accounts, prevent the corporation from treating its franchise as a source of profit. Let it earn fair dividends on the capital actually invested for the public good—dividends based on the market rate for funds for investments possessing the same low degree of risk—and restrict its net profits to such dividends, after the expenses of construction and depreciation have been provided for. The enforcement of such a pro-

gramme as this would render it impossible for a franchise to become a source of income, as a franchise.

Obviously if a franchise is not to be dealt with as a business asset and is prevented by stringent regulation from becoming a source of profit, it cannot be just to levy a tax upon it. It is not private property, for the reason that it has no economic character as an income-producing entity, and it therefore should not be taxed as private property. As a matter of fact the adoption of this principle, while it would work much harm under the prevailing lax conditions of regulation, would not be injurious to the state under a system of strict control. Franchise taxation has its function to fulfil as a check on corporate aggression, and as a means of replenishing the public coffers with a portion of the treasure extorted from the customers of the corporations; but so soon as proper control is established, the need of such a restrictive measure is removed, and the property subject to such taxation is taken away, for the reason that taxes should not be levied on property which the law would declare is to be used for the benefit of the public and not of private individuals. There seems to be the rub—if franchises had always been treated as public rights, even after assignment to private individuals, the interest of the public in them would have been constantly perceived, and the vexatious confusion of public service corporations with private ones, from which the present age suffers, would never have come about.

The custom of taxing public franchises which is so generally adopted, and the decisions of our highest courts sustaining the practice, are by no means criticised in this paper. It is believed, on the contrary, that with matters as they now are, it is better that franchises should be taxed, and in many states they are not taxed as severely as they ought to be. This practice, however, seems to the writer to find its justification in the existing régime of confused public rights and private privileges. As soon as order is brought out of chaos by careful and accurate delimitation of the powers and duties of public service corporations, and a system of more stringent control is set up, the disadvantages of treating franchises as sources of gain and subjects of bargain and sale will be realized, and it will be seen that if the public interest is to be safeguarded, public rights must always be retained under public control, and likewise the individuals or corporations permitted the use of uch rights for special purposes.

The ideal manner in which public franchises should be appraised has given rise to so much difference of opinion among economists that we can never be certain, whatever measures are adopted, that their value is not underestimated and the corporation is not presented with a bonus which robs the public. It may be doubted whether this problem of valuation can ever be settled to the satisfaction of any considerable number of intelligent citizens. The retention of franchises as public rights thus holds out the prospect of more effective control than could otherwise be secured.

The chief factor in the movement toward municipal ownership of public utilities is the absence of adequate government control of public service corporations. It is believed that the treatment of franchises as private property increases the temptation to embark in municipal ownership ventures,

It certainly is favorable to overcapitalization; moreover, as we have seen, adequate compensation for the franchise is hardly to be looked for. The treatment of franchises as public rights subjecting the grantees of the use of those rights, on the contrary, to certain rights and duties, might solve the problem for many of our cities which are vacillating between private and municipal ownership. What our cities greatly require is a system in which the advantages of private ownership and public control shall if possible be combined. Inasmuch as capital to be devoted to the public service can readily be secured at fairly low rates, the problem is not really so formidable as it appears, and the treatment of the franchise as public property would seem to furnish all the justification needed for intervention in the affairs of corporations exercising public rights for the public good.